U.S. Department of Housing and Urban Development
Office of Policy Development and Research

Volume I: Executive Summary

Real Estate Closing Costs

RESPA, Section 14a

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REAL ESTATE CLOSING COSTS

RESPA, Section 14a

Volume I: Executive Summary

October 1980

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I. INTRODUCTION

The Real Estate Settlement Procedures Act (RESPA), passed in 1974 and amended in 1975, was enacted in response to concern by Congress that settlement costs were excessive due to inefficient markets, insufficient consumer information, and anticompetitive behavior on the part of some providers. Some of the conditions and practices which motivated the passage of RESPA were:

- inconsistent state regulation of the insurance components of settlement;
- kickbacks, commissions, and referral fees among various members of the industry;
- highly variable and sometimes complex settlement practices among regions of the country; and
- consumer charges that appeared to be excessive and which were often unrelated to the cost of providing service.

Both the original and the amended versions of RESPA, attempted to deal with these and other potential issues in the settlement industry through a number of provisions. Most importantly, the Act:

- prohibited certain kickbacks and referral fees;
- required advance disclosure of settlement charges by lenders;
- required the development of a "Special Information Booklet" to be distributed to loan applicants; and
- required a uniform settlement transaction form.

The purpose of these provisions was to eliminate certain practices which were felt to be anticompetitive, such as the use of kickbacks and referral fees, and to substantially increase the availability of information to consumers. Congress felt that increased information would promote consumer shopping, which in turn would stimulate competition among service providers.

One provision of the Act requires that the Secretary of the Department of Housing and Urban Development (HUD) report to Congress concerning the necessity of further federal legislation regarding settlement procedures. Specifically, RESPA states:

> Section 14.(a) - The Secretary...after such study, investigations, and hearings...as he deems appropriate, shall...report to Congress on whether...

there is any necessity for further legislation in this area.

(b) - if the Secretary concludes that there is necessity for further legislation, he shall report to the Congress on the specific practices or problems that should be the subject of such legislation and the corrective measures that need be taken.[1]

It is in fulfillment of this mandate that the present study has been undertaken.

This study has three primary goals:

- to determine how well the settlement process is working and specifically how individual settlement service markets are performing to provide required services at a reasonable cost;

- to evaluate the effectiveness of RESPA in achieving its objectives: better informing the consumer, increasing the incidence of shopping, and ultimately lowering settlement costs where they are excessive; and

- to assess the feasibility and desirability of modifications and alternatives to the Act.

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[1]The Real Estate Settlement Procedures Act of 1974, 12 USC 2601.

II. OVERVIEW OF METHODOLOGY

Two principal research tools were used in addressing the study's objectives: (1) a national survey of Uniform Settlement Statements (HUD-1s); and (2) a number of local market studies. In addition, relevant secondary data collected through personal interviews with public officials and officers of pertinent industry organizations at the national, state, and local levels were also used to assist in the evaluation of the research issues. Finally, previous studies were examined and recognized experts were consulted regarding their assessments of RESPA performance, the performance of the settlement service industries, and proposed intervention strategies. The scope of each research component is described below.

- The National Survey. In order to derive a national perspective on settlement practices and costs, we collected and analyzed data from a nationally representative sample of 18,000 Uniform Settlement Statements (HUD-1 Forms) from institutional lenders.

- Local Market Studies. Detailed analyses of eight local markets were conducted to provide an in-depth look at the way in which local markets provide settlement services. The eight markets studied were:

  . Boston, Massachusetts;
  . Denver, Colorado;
  . District of Columbia;
  . Jacksonville, Florida;
  . Los Angeles, California;
  . St. Louis, Missouri;
  . San Antonio, Texas; and
  . Seattle, Washington.

  In each site personal interviews were conducted with a sample of home buyers, home sellers, and settlement service providers. The settlement service providers analyzed are real estate brokers, mortgage lenders, attorneys, title insurers, and private mortgage insurers.

  In addition to these local market studies, home buyers and sellers were surveyed regarding their settlement experience in ten additional sites.

- Secondary Source Interviews. In addition to the interviews with consumers and providers of settlement services, more than 80 personal interviews were conducted with national, state, and local public officials and officers of relevant industry associations.

III. PRINCIPAL FINDINGS REGARDING RESPA PERFORMANCE

The success or effectiveness of RESPA rests on its ability to bring about active price competition in the settlement service markets resulting, by implication, in lower prices for settlement services. "Effectiveness" refers to the extent to which program inputs (i.e., RESPA's provisions, rules, and regulations) lead to desired program outputs (i.e., greater and more active price competition among settlement service providers and lower settlement service prices).

A model-based approach was used for assessing the effectiveness of RESPA and for cataloguing its various impacts. The model consists of three distinct but interrelated components:

- Compliance/Implementation - This component considers the extent of compliance with RESPA's rules, regulations, and provisions and the degree to which they are fully implemented and are an ongoing part of the settlement system. RESPA requirements examined included the Special Information Booklet (SIB); the Good Faith Estimates (GFEs); and the one-day prior inspection of the HUD-1. Other RESPA provisions were not examined because of lack of data or because they were deemed (by HUD) to be of secondary importance.

- Systems Changes - This component considers the extent to which certain structures, practices, and relationships within the settlement industry and certain consumer behaviors and actions have changed as a result of the implementation of RESPA. The focus here was on the extent and characteristics of the SIB readership and on consumer shopping.

- Price Impact - The component considers the extent to which changes in the settlement markets have led to greater and more active price competition among providers and have provided downward pressure on the prices charged for settlement services. This component estimated current settlement charges and investigated whether and to what degree, settlement charges have changed since RESPA's enactment.

Our examination of RESPA compliance and implementation indicates that the letter and intent of the RESPA provisions we have studied are, for the most part, being complied with. We have found that:

- Nearly all lenders claim they distribute the SIB and GFEs within the required time frame;

- Most consumers receive the SIB (57 percent) and GFEs (83 percent);

- Most consumers find the SIB to be adequate and the GFEs to be reasonably accurate estimates of actual settlement charges;

- Most consumers (70 percent) and providers (60 percent) view the Uniform Settlement Statement as a reasonably adequate, understandable, and convenient document for displaying settlement charges; and

- The one-day prior inspection of the HUD-1 is made available to home buyers, although few (20 percent) exercise the right.

Key findings from our analysis of changes in the settlement system, process, and procedures include:

- Between 8 and 9 of every 10 home buyers who receive the SIB reported that they read all or some parts of it;

- Four of every 10 home buyers engage in some degree of comparative shopping; and 5 of 10 shopped for lenders,[1] 1 in 10 shopped for title companies, and 3 in 10 shopped for attorneys; and

- The RESPA provisions induce at least 1 of every 10 home buyers to engage in some degree of comparative shopping.

Finally, the price impact component of the model indicates that:

- For the 50 states and 8 SMSAs for which data were collected, total settlement charges not including broker fees averaged $2,030, or 3.7 percent of the average contract sales price of $54,864. This percentage ranged from a low of 1.6 percent in Iowa and Kansas to 6.8 percent in Oklahoma. Broker fees were excluded because they often were not listed on the HUD-1. Where they were listed, they were 5.8 percent of the sales price or considerably more than all other settlement costs combined.

- Total settlement charges, less broker fees and transfer and pre-paid taxes, averaged $1,657, or 3.0 percent of average contract sales price, with a low of 1.2 percent in Vermont and a high of 6.3 percent in Oklahoma and Mississippi.

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[1] Lender percentage includes home buyers who claimed that some other party shopped for a lender for them.

- The most expensive group of settlement related costs were those related to loan origination. This group of costs averaged $975 or 48 percent of total settlement charges. Average title charges, at $389 (19 percent), were next most costly. Items required by the lender to be paid in advance of settlement averaged $318 (16 percent); government recording and transfer fees averaged $253 (12 percent); reserves averaged $211 (10 percent); and additional settlement charges averaged $104 (5 percent).

- The distribution of individual and total settlement charges between buyer and seller varies widely across geographic areas, reflecting great diversity of local and regional practice.

- In the four coincident sites covered in both the 1975 and 1979 HUD-1 surveys, average total title assurance charges (including the cost of search and related services) increased 11 percent, from $427 in 1975 to $475 in December 1978. This compares to a 45 percent increase in the average contract sales price of homes in these sites and a 24 percent increase in the Consumer Price Index over this same period. These data, although limited, indicate that average total title insurance charges declined in real terms over this three and one-half period.

- Information provided by both our surveys of title insurers and our discussions with related groups indicates that the title insurance premium schedule used in most localities has not changed in recent years. This schedule calls for premiums to increase slightly less than proportionately with the sales price. The relatively small (11 percent) increase observed in the four sites between 1975 and 1979 may reflect primarily increased competition among attorneys and other providers who arrange for title insurance and related services, and a resultant decline in the price of those other services. The reader should be cautioned, however, that the observed price behavior in these four sites may not be representative of the national experience during this period.

MAJOR FINDINGS REGARDING PERFORMANCE OF SETTLEMENT SERVICE MARKETS

In each of the industries we studied, the general questions we sought to answer were:

- Does active price competition exist?

- Is the consumer well served in terms of being provided with necessary settlement services at a reasonable price?

- Do settlement practices exist which detract from overall performance?

An assessment as to whether active price competition exists within the settlement markets is important because where it does exist, market forces drive providers to supply services efficiently and at prices close to the cost of production. Inefficient and high-priced providers are simply forced out of the market.

Two primary approaches were used to evaluate the extent of price competition in settlement markets. First, we assessed the degree to which the following classical economic criteria for perfect competition are met:

- The product is homogeneous so that consumers are indifferent among alternative providers;

- There are numerous independently acting buyers and sellers;

- Buyers and sellers possess perfect information about price and other market conditions; and

- No substantial barriers exist to inhibit entry into or exit from the industries providing settlement services.

Though perfect competition is an idealized state, the degree to which these requirements are met can help indicate the extent that active price competition is present within a market place. These requirements also can help in selecting those alternatives or interventions that should be considered to improve market performance.

Second, we analyzed three considerations that we believe are critical to the presence of "workable competition." These include: (1) aspects of market behavior, such as price behavior over time and across different market conditions; (2) evidence of low productivity or the persistence of unusually high profits; and (3) the extent reverse competition.

Workable competition may be roughly defined as active price competition. The question of price competition is important in the area of settlement services because of the existence of reverse competition in title insurance, mortgage insurance, and to some degree attorney conveyancing services. Under a system of reverse competition: (1) services are sold through intermediaries or referrers; (2) providers increase marketing costs in attempting to gain referrals; and (3) price competition in the conventional sense does not exist because the buyers do not actually choose the service provider in question.

The basic concern of the Congress in the area of settlement services is whether the charges to home buyers and sellers at settlement are reasonable. In other words, are the services provided at the lowest possible cost and in a way that assures high quality. Part of the congressional concern centers on protection required by lenders which defines the need for title insurance, mortgage insurance, and transfer documentation. These services may be of only marginal interest to buyers and sellers. Nonetheless, the efficient functioning of the secondary mortgage market requires that services be provided which are designed to reduce risk.

The existence of active price competition is not the only determinant of performance of the settlement service markets. If provider practices or requirements exist which result in the purchase of inappropriate or excessive services, then the consumer is being ill served, regardless of the reasonableness of the prices for those services.

Some overall findings regarding all or several of the settlement service markets are:

- Consumers continue to be relatively poorly informed regarding settlement services and therefore often require assistance in choosing settlement service providers.

- Competition exists primarily for referrals rather than directly for the consumer's business (i.e., reverse competition). Prices appear to be higher than they would be if markets were more directly price competitive. However, while the effects of reverse competition do generally raise charges, they may provide greater market effeciency and some indirect benefits to consumers.

- With the exception of mortgage lending, price competition is not prevalent among the four other settlement service markets.

- Some provider practices exist which appear to add unnecessarily to settlement charges.

It is important also to note that the high prices for settlement services do not stem primarily from some of the more well-known classical causes (in economic theory) of high prices. Monopoly (one supplier), oligopoly (only a few suppliers), or substantial barriers to entry into the market tend not to be characteristic of settlement service markets and therefore are not primary causes of high prices. Consequently, some of the classical remedies such as increasing the number of suppliers and removing barriers to entry will not significantly improve the performance of settlement service markets and, these offer only limited policy guidance.

(We should note that significant forms of non-price competition exist among settlement providers; some of these provide indirect and important benefits to consumers. For example, mortgage insurers compete by offering

services which assist lenders in marketing their mortgages to the secondary mortgage market; this in turn provides the requisite liquidity and capital needed to make mortgage money available at a reasonable cost.)

The findings noted above are discussed briefly as they pertain to the individual settlement markets examined.

PERFORMANCE OF THE BROKERAGE INDUSTRY

Real estate brokers assist the seller in finding a buyer for his house, in concluding the sale, and possibly in arranging post-contractual requirements. Of the 83 percent of sellers in our survey who used brokers, most (94 percent) used traditional, full service brokers who are compensated on a commission rate basis. Discount commission rate firms and flat fee firms offer a reduced set of services and consequently charge less than traditional firms.

A prominent finding of our study identified a major absnece of active price competition. This is the case despite: (1) a lack of significant barriers to entry; (2) a large number of providers; and (3) the highly competitive nature of real estate brokers (manifested in other ways than reducing commission rates). Commission rates tend to remain at either exactly 6 percent or exactly 7 percent across significantly different market conditions. This finding, when considered along with past efforts of broker organizations to stabilize commission rates, strongly suggests that prevailing commission rates are not determined within a competitive market setting. Moreover, the mechanisms of the multiple listing service (MLS) and cooperative sales among brokers both seem to discourage firms from reducing commission rates and both serve as a commission rate monitoring device for member firms.

This lack of active price competition, combined with escalating house prices, has resulted in the payments of particularly high commissions. This, in turn, has likely contributed to an increased number of real estate sales agents, and has reduced their productivity from what it would be in a more price competitive environment.

Other significant findings are:

- Despite the high commission charges, it appears that the relatively low productivity in the industry results in only average profits for the entrepreneurs of the industry;
- Consumer satisfaction with services provided by brokers is relatively nigh; and
- Brokers function as an important source of referrals for other settlement services, primarily for mortgage loans, title insurance, escrow services, and occasionally mortgage insurance.

The market performance of the brokerage industry is fair: brokers are satisfying their consumers in terms of the quality of services provided, but a price competitive environment, which can ensure that these services are provided efficiently and at a reasonable price, is largely absent.

PERFORMANCE OF THE MORTGAGE LENDING INDUSTRY

The lender is at the center of the settlement process. In addition to supplying the mortgage loan, he largely determines what other settlement services are required and often who provides them. He is also an important referrer for all settlement services other than brokerage. He has been given primary responsibility for fulfilling the requirements of RESPA, and especially those relating to consumer education.

Mortgage lending is the most price competitive of the settlement service industries studied. Barriers to entry do not appear to be significant. There are typically many providers in most large urban areas, and we have found no indication of either explicit or implicit collusive behavior regarding mortgage interest rates. Further, our analysis of mortgage interest rate behavior in four markets at two points in time suggests a relatively high degree of active price competition.

It is in some of the lenders' other roles in the settlement process that deficiencies may occur. Some lenders require services that are redundant or exceed their own legitimate secondary market needs to ensure the safety and security of mortgage loans. For example, some lenders require their own attorney to review documents prepared by the buyer's attorney; over 40 percent of all lenders interviewed for this study required the use of a specific attorney. While lenders are entitled to legal protection of a document review by a qualified and knowledgeable attorney, designation of a particular attorney creates a noncompetitive pricing situation for the borrower. Also, in referring or requiring the use of other settlement providers, some lenders rely on those with whom they have business relationships, often without informing the buyer of those relationships.

The overall assessment of market performance of the lending industry is that it is relatively good. Lenders appear to deliver their primary product efficiently and at reasonable cost. But in requiring or arranging for the provision of other settlement services, they are often insensitive to the cost to the consumer.

PERFORMANCE OF THE PRIVATE MORTGAGE INSURANCE INDUSTRY

Private mortgage insurance is generally required by lenders when less than a 20 percent down-payment is made on a home that is being conventionally financed. In providing this service, the mortgage insurer agrees to absorb a

set portion of the loss that would result from a borrower's defaulting on his mortgage loan. This insurance facilitates the making of high loan-to-value-ratio (LTVR) loans by allowing the lender to transfer to a third party some of the risk inherent in such conventional mortgage lending. Such private mortgage insurance has contributed substantially to both greater liquidity among conventional loans in the secondary market, and to broader home ownership among households lacking the financial resources to make large (i.e., 20 percent or greater) down payments.

Typically, the purchase of mortgage insurance is arranged through the lender; the mortgage insurer and the home buyer almost never meet or discuss characteristics of the service, payment options, or price. Therefore, ambiguity may exist as to whether it is the lender or the home buyer who is the buyer or consumer of the insurance product.

The mortgage insurance industry has exhibited a mixed performance in fulfilling the four criteria for perfect competition. From the perspective of the home buyer, the basic insurance product is highly homogeneous. However, because of the nature of ancillary services and because of the importance that lenders place upon the financial integrity of the insurer, significant product and insurer differentiation is perceived by lenders.

The concentrated structure of the mortgage insurance industry also retards its ability to behave in a perfectly competitive fashion. Although the industry has become somewhat less concentrated during the past decade, the largest firm (in terms of annual premiums written) accounted for 40 percent and the largest four firms for 73 percent of market share in 1979. The industry's oligopolistic structure is reinforced by entry barriers that take the form of significant capitalization and, at times, established market recognition that is often necessary to move into new geographic market areas.

The final condition of perfect competition requires the availability to both buyers and sellers, of perfect market information. Industry performance relative to this criteria is again inhibited by the nature of reverse competition, which dictates that lenders, and not consumers, actually select the mortgage insurer. Significant information is available to both lender and insurer, and this contributed both efficiency and productive rivalry to the marketplace. The home buyer, however, is basically left out of the flow of relevant information and is often poorly informed.

A study of industry pricing behavior in the industry indicates that there is little active price competition. With the exception of two firms whose combined market share is less than one percent, prices are nearly identical for similar payment plans. However, some implicit price competition may be developing in the form of an increasing number of payment plans, some of which represent price reductions from the older plans.

The weakness of active price competition results in part from the strong pattern of reverse competition. Mortgage insurers market almost exclusively to sources of referral (i.e., lenders and, to a lesser extent, real estate

brokers). Eighty percent of the lenders surveyed indicated that they choose the mortgage insurer. However, mortgage insurers do compete for lenders by offering them additional services, some of which are important to the lenders in managing their secondary market operations. Our interviews indicate that price is relatively unimportant in both insurer marketing and in lender selection.

Prices within the mortgage insurance industry are probably higher than they would be in a more competitive environment. This is due in part to (1) the industry's inconsistent performance in fulfilling the four criteria of perfect competition; and (2) the lack of active, competitive pricing that results from the strong pattern of reverse competition. Prices may also be high as a result of the 50 percent reserve requirement that is stipulated by state insurance commissions. Loss ratios have been relatively low. They have ranged from about 10 to 25 percent for all firms during 1976-1979, and reserves have been used only infrequently since 1957. However, it is important to recognize that the industry's ability to withstand a substantial economic catastrophe has not been truly tested, and it was for such a scenario that the 50 percent reserve requirement was initially established.

The overall performance of the mortgage insurance industry has been good insofar that it provides for the efficient delivery of a quality product to lenders. It has contributed significantly to fostering home ownership and mortgage market liquidity. However, the existing delivery mechanism allows lenders to be relatively insensitive to price. This suggests that premiums may be higher than is necessary to maintain existing levels of quality and financial security.

PERFORMANCE OF TITLE ASSURANCE AND CONVEYANCING SERVICES INDUSTRIES

The overall evaluation of the title assurance and conveyancing service industries revealed that active price competition generally does not exist. Conveyancing services in this study referred to settlement or closing services, escrow services, and document preparation. These routine services are usually performed by the provider of title assurance, who is either an attorney or a title insurance company representative. We believe the total package of title assurance and conveyancing services is the correct combination of services to analyze for this study.

We found that total charges for title assurance and conveyancing services vary by over 100 percent among the eight study sites. There is little or no corresponding difference in the cost of operation, indicating that charges are considerably higher than required for viability in many market areas. Charges depend on historical and customary practices and on state regulations in a particular area; and they seem not to reflect influences of supply and demand.

Neither losses, search costs, nor other title insurance industry costs are significantly related to house sales prices, even though rates and charges are so related. Losses are typically only a small portion of total premiums.

Title insurers receive most of their business from referrals by real estate brokers and agents, lenders, and attorneys. Thus, reverse competition, or the practice of competing for referrers rather than customers, is widespread. Reverse competition has continued to exist over a long period of time because consumers are not well informed regarding title assurance; they generally accept referrals from other real estate professionals.

Interlocking relationships between referrers and title companies are a continuing trend in the industry. The most common interlocking relationships exist between lenders or attorneys or real estate brokers and title companies. The relationship between lenders (S&Ls) and title companies is principally through their (service) corporations.

We did not find that where the title assurance services are provided by a "controlled business," the charges for title assurance services were either higher or lower than the charges in markets where attorney agents or title insurance companies provided the service. Nor were we able to ascertain whether the presence of attorneys in the settlement process resulted in higher or lower overall charges.

As noted earlier, we did find that, between 1975 and 1979, the combined price of title assurance and conveyancing services declined in real terms in four localities studied. This may or may not, however, reflect the national experience.

THE ROLE OF ATTORNEYS IN SETTLEMENT SERVICES

Attorneys provide services in three general areas of the settlement service process:

- title assurance;
- conveyancing services (i.e., document preparation, settlement or closing, and escrow); and
- contract negotiation and other arrangements.

Other types of participants often perform all of these services. In fact, attorneys usually play little or no role in the real estate transfer process in the Western states. However, in most Eastern states, their role is significant.

This study addressed attorney participation principally in terms of their role as providers of the title assurance and conveyancing services. We felt that the use of attorneys to aid in contract negotiations and other arrangements was important for both buyer and seller. The charges for this type of service are often assessed on an hourly basis, and the type of help offered to clients varies from situation to situation.

While many home buyers undoubtedly hire an attorney before they sign a contract, attorneys often enter the process only to perform title assurance and routine conveyancing services. Since these same services are often performed by nonattorneys such as title insurance companies, real estate brokers, and lenders, this study looked more intently at the role of the attorney specifically as a provider of these latter services.

Title Assurance

Of the eight sites studied, Boston was the only area where the use of attorney's opinion was widespread. However, in many areas where title insurance is used, attorneys remain an integral part of the process. They are often attorney-agents for the title insurance underwriters. In such situations, attorneys often perform or supervise the title search and evaluation, and then sell the title insurance policy, as agents for the insurance underwriter.

We found that attorneys are often paid for the search and evaluation and conveyancing services as separate items; they often receive 50 percent or more of the title insurance preimum as a commission for this service. However, because of the small number of sites studied where there was extensive attorney involvement, we were unable to determine if total title-related charges were higher in these sites than where attorney involvement was less common.

The existence of lender-required attorneys for review of the documents is widespread; over 40 percent of the lenders we interviewed had such a requirement. This figure was higher in areas such as Boston and Maryland, where the use of attorneys is widespread. We believe that workable competition is virtually precluded if a borrower is effectively prevented from shopping for an attorney. However, the lenders do (and should) have the right to legal review to protect their interests. The issue is how to achieve that protection at the least cost to borrowers.

Conveyancing Services

The term "conveyancing services" was used in this study to describe conduct of settlement, escrow services, and preparation of documents such as the deed, the mortgage, and the transfer of title. Usually the direct supplier of title assurance also supplies conveyancing services. The provider of conveyancing services is usually a title insurance company, an attorney, or an escrow company.

Advertising and Minimum Rates

In the past few years attorneys, for the first time, have been able to advertise professional services. During this period, the U.S. Supreme Court has also ruled that minimum fee schedules set by state bar associations are illegal. Our surveys indicated that very few attorneys advertise settlement services. However, many attorneys believe that the profession has become more price competitive. The apparent decline in the real charges for the title assurance and conveyancing services between 1975 and 1979 seems to bear this out.

We believe that attorneys have a unique role in providing advice and consultation to home buyers and sellers in their sales contracting. However, other professionals can and do provide title assurance and conveyancing services in many market areas.

IV. DEVELOPMENT OF ALTERNATIVES

The settlement service markets examined in this study demonstrate several common characteristics that should be evaluated in any consideration for intervention. These characteristics may not be present for each settlement service, but they are widespread and have a significant influence on overall market performance. These characteristics are as follows:

- Consumers have limited information about products, providers and prices.
- Direct shopping for settlement services is limited.
- Direct consumer access to insurance providers is limited.
- Providers compete primarily for referrals rather than directly for consumers' business, i.e., reverse competition.
- Providers tend to compete through non-price competition (product differentiation, additional services, etc.) rather than through active price competition.
- Certain factors (other than reverse competition) are present which tend to discourage price competition:
  - vestiges of established and generally accepted industry-wide rate schedules;
  - inconsistent state rate regulation; and
  - cooperative agreements among providers.

  The presence of tied relationships, lack of adequate consumer information, or lack of direct competition for consumers.

This listing is not intended to create an impression that excessive prices, poor quality, or inappropriate services are prevalent in settlement markets throughout the country. Rather, such conditions are presented as deviations from the ideal: a market characterized by active price competition in which providers are responsive to the needs and informed demands of consumers. In fact, these observed characteristics of settlement service markets result in: (1) the consumer in many localities paying higher costs than necessary for settlement services; and (2) the requirement in some cases for services that are inappropriate or excessive. The alternatives developed in

this study present a range of actions designed to remedy these characteristics of market performance. They include: (1) alternatives advanced over the past ten years by students and practitioners of the industry; and (2) variations we have considered that might improve or correct inefficient market performance.

The consideration of alternatives to RESPA that were mandated in this study has as its principal objectives, the improvement in price competition in settlement services. We have found that significant forms of non-price competition exist among the settlement providers. Many of these provide indirect benefits to sellers and buyers of homes. The remainder of this volume, however, deals only with alternatives intended to improve or encourage price competition. We have attempted to evaluate these alternatives in terms of their anticipated efficacy in increasing price competition; our evaluation also addresses the expected "downside" effects, such as difficulties of implementation and the disruptive aspects of these alternatives.

METHODOLOGY FOR DEVELOPING AND EVALUATING ALTERNATIVES

Clearly, the first task in developing alternatives for policy intervention is to identify the principal objectives of any intervention involving market practices. Because some objectives may hinder or even be inconsistent with others, it is also important to establish an order of priority. The potential list of objectives for policy intervention include the following:

- Reduce settlement costs;
- Ensure that only appropriate services are provided;
- Eliminate settlement processes which tend to raise charges;
- Provide consumers with easier access to relevant information about settlement services; and
- Reduce financial barriers to home ownership by lowering costs required at settlement.

The highest priority has been given to reducing settlement costs where they are found to be excessive. However, it is also important to ensure that services are responsive to the requirements of consumers and are not in excess of their needs or the legitimate needs of providers. As discussed throughout this study, both (1) the complexity and highly technical nature of settlement services, and (2) the narrow experience of most home buyers, contribute to the inadequacy of current levels of consumer information describing settlement services. The consumer potentially may be led into buying inappropriate or excessive services. As enacted, RESPA is intended to educate the consumer so that he will obtain only needed settlement services at minimum cost.

The process by which consumers gain convenient access to relevant information should contribute, in theory, to lower costs and to the provision of only appropriate settlement services. This process is, itself, an important objective. However, many would argue that public policy must only provide the consumer with the tools necessary to make intelligent decisions in a well functioning market, and that public policy need not be concerned with whether he makes the right decisions. Access to adequate information thus becomes an end in itself, rather than just an improvement in a process designed to achieve certain objectives.

Access to relevant consumer information is important for another reason: efficient and well functioning markets that are responsive to consumer concerns are not possible without informed consumers. Such access can therefore be considered an essential precondition for workable competition and for good performance in the settlement service markets.

HUD has long been concerned with reducing economic barriers to home ownership, and a decrease in those costs required at settlement may enable some cash-short consumers to become home owners. While this goal may be important, there is little in RESPA's legislative history to suggest that a reduction in settlement costs by means of a deferral of those costs into higher subsequent monthly payments, might be an explicit goal of the program. Therefore, while we recognize that it is desirable to reduce economic barriers to home owners, we do not consider this a primary objective of either RESPA or of any of the analyzed alternatives.

THE NEED TO EVALUATE ADVANTAGES, DISADVANTAGES AND RISKS

The process of evaluating alternatives includes a discussion of both their advantages and disadvantages. As many parties may be affected by policy and regulatory interventions, it is important both to identify them and to explain the nature of the impact. In order to provide some perspective as to the dimensions of both the problems and the proposed interventions, the dollar magnitude of both current costs and potential savings is sometimes estimated.

There is some risk that the alternatives evaluated will not work as planned. Some proposed alternatives involve substantial changes in the process of providing settlement services. For this reason, it is important to determine whether the intervention is reversible; that is, if it is tried and does not work, can the status quo be reestablished? This question is addressed specifically for those alternatives which involve major changes in the settlement process.

Each alternative is considered separately and not in tandem. Clearly, many may be mutually compatable and may be assembled into a package. However, there are some that are mutually exclusive or cannot be implemented concurrently. In any case, we have attempted to construct no "best combination,"

since that is beyond our charge. If combinations of alternatives are contemplated, then the stated advantages, disadvantages, and evaluations we have included singly might have to be reconstructed in order to assure that the combined effects are not other than the sum of the individual alternatives.

In the following pages, we summarize our findings with regard to the more salient of the alternatives that we have analyzed. In the order they are presented, these include: (1) alternatives to improve consumer information and encourage shopping; (2) the lender-pay alternative; (3) alternative relating to mortgage lending; (4) alternatives relating to mortgage insurance; (5) alternatives relating to title insurance; and (6) alternatives relating to real estate brokerage services.

Included in this summary are only the more important alternatives that we have considered. The numbering corresponds to the numbering in the Alternatives Volume (Volume III). Consequently, each alternative is not summarized here, and there are skips in the numbering presented below.

ALTERNATIVES TO IMPROVE CONSUMER INFORMATION AND ENCOURAGE SHOPPING

Alternative 1: Repeal RESPA

The repeal of RESPA by an Act of Congress would be justified if: (1) only marginal consumer shopping could be attributed to it; (2) it were ineffective in achieving an overall reduction in settlement costs; and (3) the economic costs of repeal did not outweigh the costs of allowing the Act to remain in effect.

Our evaluation of RESPA performance indicates that RESPA has induced some increase in consumer shopping for settlement services, that it may have resulted in an increased level of price competition in some markets, and that repeal of RESPA may be more costly than the maintenance of RESPA requirements. We, therefore, do not recommend its repeal.

Alternative 2: Maintenance of the Status Quo

Maintenance of RESPA in its current form would be justified if modifications to RESPA are not likely to improve the performance of the settlement service markets and reduce settlement costs. We believe that performance of the settlement markets can be improved through changes in RESPA.

The following four alternatives involve modifications to RESPA. They are designed to provide more useful consumer information, to increase consumer shopping and to increase the extent of price competition in the settlement service markets. Each of these alternatives would require that Congress enact amendments to RESPA.

Alternative 3-1: Distribute the Special Information Booklet (SIB) Earlier

Our industry and consumer interviews suggest that having the lender distribute the SIB is relatively ineffective in providing information that is useful in the purchase of settlement services. The real estate agent is typically the first settlement provider to come in contact with the home buyer and thus represents the logical source for providing information about the settlement process. Receiving the SIB before the initial contact with a lender would enable the home buyer to more knowledgeably question the lender(s) about settlement requirements and options. It also may assist the buyer in choosing a lender who can offer the most advantageous terms.

We believe that the real estate agent represents a more effective source of distribution of the SIB; we believe that providing him with responsibility for distribution would increase the incidence of shopping for settlement services. However, questions of federal jurisdiction over the brokerage industry persist. Consequently, voluntary participation in the brokerage industry is highly desirable.

Alternative 3-2: Distribute SIBs that are Specific to a Locality

As settlement service practices and requirements differ by locality, the SIB could be improved if it provided information on specific regional practices for the area where the settlement is occurring. An abridged version of the SIB could be prepared at the national level which would be modified and expanded to reflect local settlement practices. We think most states would require only a single SIB, although some cities within a state might warrant specially prepared SIBs.

We recognize that developing local SIBs would be more costly. We recommend this action, however, because it would be particularly useful in selected sites where archaic and sometimes confusing settlement practices persist. A locally specific SIB could be designed to provide much relevant and detailed information that is currently absent from the standard SIB, or obscured by its general tone.

Alternative 3-4: Require Earlier Delivery of the Good Faith Estimate (GFE)

Currently, the GFE is not provided to the home buyer until after the loan application, and often not until after he has paid for such items as the credit report and appraisal, and perhaps paid an application fee. The GFE is most useful if it is provided before certain settlement-related decisions are made, and before expenses are incurred.

Requiring the lender to provide the GFE before the loan application would significantly alter the loan application and evaluation process, and could delay the loan approval. However, it would place the home buyer in a significantly better position to comparison shop for a mortgage and for

other settlement services. In addition, earlier provision of the GFE may require some change in format. The earlier the GFE is provided in the process leading up to loan closing, the less precise the estimates may become. Consequently, broader ranges of estimated charges may become more prevalent. Nevertheless, we recommend that this alternative be seriously considered for implementation. It is possible that this alternative would cause lenders to incur some additional costs, and we recognize that these costs would have to be passed on to borrowers in nominal application charges.

Alternative 3-5: Ensure More Uniform Completion of the HUD-1 Form

Our analysis identified a substantial lack of conformity in reporting certain costs or groups of costs on the HUD-1. Often real estate commissions were not included at all. As a result, the home buyer or home seller may have little idea of what is being paid for specific services. Lenders and other settlement agents should be better instructed and trained in the preparation of the HUD-1.

These recommendations for modifying RESPA are designed primarily to provide the consumer with useful information regarding settlement practices at a point when he can more effectively shop for settlement services. This would help introduce more competition into the markets for these services. We believe that the changes suggested by these alternatives are consistent with the spirit of RESPA and would assist in fulfilling each of the policy objectives that were earlier identified.

LENDER-PAY ALTERNATIVE

The lender-pay alternative incorporates the idea that the mortgage lender would become more motivated to select only necessary and reasonably priced settlement services if he bore responsibility for the cost of such services. These would include services associated with the loan, including mortgage insurance, title assurance services, and conveyancing services. The lender would decide what services were necessary and would either provide them himself or purchase them from other providers. The buyer would have one primary decision to make regarding settlement services--the decision of which mortgage lender to select.

The rationale for believing that lender-pay would lower settlement charges is based upon these assumptions:

- the lender is in a favorable or advantageous position to either provide or negotiate for the efficient provision of required settlement services;

- the lender would be under competitive pressure to offer those services to the consumer at a reasonable price--less than the sum of current prevailing prices for those individual services; and

- shopping for settlement services would be simpler, less time consuming and less costly for the home buyer.

The home buyer could pay for the settlement services through:

- an increase in the interest rate;
- an up-front, lump-sum payment; or
- an increase in the loan amount (or a separate loan).

Section XIV of RESPA specifically mandates that the concept of lender-pay be studied as a viable alternative to the present process of obtaining settlement services. Under this concept, all lenders would be required to provide settlement services as a package. Consumers would not be required to purchase numerous services and products which they may not fully understand. The lender would provide one total package for all necessary legal, financial, insurance, and conveyancing services.

If lender-pay is adopted, we feel the up-front, lump-sum payment for settlement services would be most effective. It would be the easiest of the three to implement; it would be most comprehensible to borrowers, and it would cause the least disruption in the secondary mortgage market.

We believe that most lenders would be able to arrange for settlement services at lower than prevailing prices. Whether they would have sufficient incentive to do so is uncertain. While our analysis of the mortgage lending market indicates that it is the most price competitive of the settlement service markets studied, competition may not be consistently robust to induce lenders to offer settlement services at lower than prevailing prices under a lender-pay plan.

Lender-pay proposals do not mention the role of state regulation of lines of insurance. Clearly, compelling lenders to engage in packaging settlement services with the expectation that they would negotiate lower charges with underwriters is inconsistent with most state regulatory practices vis-a-vis insurance. Without a change in existing state practices in regulating both mortgage and title insurance, the ability of the lender-pay plan to significantly reduce settlement charges would be substantially impaired.

Nevertheless, we believe the potential for reduced settlement charges under a lender-pay plan should be explored. We favor a program to test its implementation on a pilot basis during which federal regulators would encourage lender participation. We do not believe there is sufficient assurance of its success to recommend its implementation on a national basis.

ALTERNATIVES RELATED TO MORTGAGE LENDING

The mortgage lending industry was found to be more price competitive than any of the other settlement services industries. By and large, it performs efficiently and at a reasonable cost to channel available mortgage funds to home buyers requiring mortgage loans. Yet, from the home buyer's perspective, certain practices do exist, particularly in times of rapidly rising interest rates, which put those least knowledgeable about mortgage financing at a disadvantage. Some of the possible process changes which could assist consumers without causing disruption to the mortgage lending industry follow. Any of these alternatives could be implemented administratively either by HUD or those regulatory agencies with jurisdiction over different mortgage lending groups.

Alternative 1: Encourage Home Buyers to Shop for a Loan Commitment Prior to Shopping for a Home

This alternative should assist in the home buying process by: (1) indicating to the buyer the size of the loan for which he can qualify, and (2) indicating to the seller (and broker) whether the buyer is a financially qualified purchaser of his property. It could also result in a quicker settlement after the sales contract is executed.

On the negative side, it could result in many more loan commitments than loans closed. This would impose on the lender some additional costs which would be recovered in the form of higher application charges or higher yield requirements. However, we favor this alternative because of the overall increase in efficiency it would likely introduce to the settlement process.

Alternative 2: Require that Lenders Provide up to a 30-day Commitment at a Stated Mortgage Rate

During periods of sharply rising interest rates, home buyers may be faced with significantly higher mortgage payments than they either anticipated or are able to afford. In some cases, borrowers might no longer qualify for the loan. This alternative transfers some of the risk of rising interest rates from the home buyer to the lender, but it also could result in higher interest rates charged to some or all borrowers. We do not enthusiastically support this alternative but we recognize that a step as potentially harsh as this is necessary to prevent the kind of severe penalties that have been placed upon loan applicants during recent periods of rapidly rising interest rates.

Alternative 3: Encourage Lenders to Provide Borrowers the Option of Increasing the Interest Rate and Reducing Points

The combination of interest rate and discount points may make it difficult for the borrower to compare loan costs among different lenders.

It can also result in substantial up-front costs at closing. To a large degree, the practice of charging points is related to VA- and FHA-guaranteed loans. Under these programs, interest rates may be for various reasons, maintained at below market rates. As a result, lenders compensate and achieve their necessary yield by charging "points" at the time a new loan is originated.

We recommend that conventional lenders be required to offer the borrower the alternative of agreeing to pay a higher interest rate in exchange for no points or reduced points required at settlement. We recognize that the terms of this "exchange" will have to be structured in order to be equitable from the perspective of both lender and borrower.

Alternative 4: Encourage Local Publishing of Mortgage Financing Costs Charged by All Local Mortgage Lenders

In many localities, private publishing services collect and distribute comparative mortgage financing terms, often on a weekly basis. This information, if readily available to home buyers, would assist them in obtaining the most suitable and favorable terms available. Federal state, and local agencies could publicize the availability of this information and seek to make it more accessible to home buyers, where private sources do not exist. Reference could be made to its availability in the SIB. We favor this alternative.

ALTERNATIVES RELATED TO MORTGAGE INSURANCE

Private mortgage insurance, like its FHA counterpart, is marketed primarily to mortgage lenders. While several of the smaller mortgage insurance firms have sought to increase their market share by offering policies at below industry prevailing prices, price competition is not dominant among major providers. Most of the alternatives discussed in our analysis seek to promote more active price competition and lower prices for mortgage insurance. Some of these alternatives follow.

Alternative 1: Require that Greater Information be Provided to Borrowers Concerning Mortgage Insurance Policies, Forms, and Premiums

Information that should be introduced to a revised SIB would include statements that:

- Prices are not necessarily uniform among lenders;
- Various premium payment plans are available and premiums are lower if the down payment is 10 percent or more;

- Conditions under which private mortgage insurance may be terminated may vary by lender;

- Refunds for unexpired prepaid insurance premiums are typically due the home buyer; and

- Conventional mortgage insurance may be less expensive than FHA insurance in terms of the costs of both purchasing and renewing required insurance.

The home buyer is often unaware of important options and complexities relating to mortgage insurance, and this type of information would assist him in selecting the insurance provider and policy most suitable for his needs. The presence of this information in the hands of home buyers would also promote greater price competition among mortgage lenders. This alternative could be implemented by HUD in its revision of the SIB.

The next four alternatives could be implemented through regulation by the federal financial institutions' regulatory agencies.

Alternative 2: Require Payment Options to Single, Prepaid Policies

While all major insurers offer several payment plans, some lenders may require that a home buyer prepay the entire premium at closing. We do not believe that borrowers should be denied this option, but we recommend that lenders be required to offer payment options to home buyers allowing both single premium and renewal policies. Although this complicates a borrower's decision-making, it may provide significant reductions in settlement costs for a small percentage of the home buying population.

Alternative 3: Require that Mortgagors be Given a Choice From a Select Group of Insurers

Reverse competition would be diminished, and price competition enhanced, if the consumer were allowed to participate in the selection of the mortgage insurer. This alternative suggests that lenders be required to offer borrowers a choice from among three to five mortgage insurers. This alternative does not assure lower insurance premiums, because (1) it might force the insurers to embrace a program of more costly retail marketing; (2) it does not ensure that those insurers who have been price competitive would be included in a list of alternative insurers; and (3) it ultimately relies upon cooperation and explanation provided by the lender. However, we recommend that it be considered for implementation on a pilot basis so as to evaluate its costs and benefits.

Alternative 6: Encourage State Insurance Commissions to Evaluate More Closely the Extent to Which Premiums Are Reasonable

Mortgage insurance tends to be a relatively low priority for insurance commissions and few to whom we spoke have engaged in in-depth evaluation of premium rates or reserve requirements. This alternative envisions a national study of this subject, under federal, NAIC, and industry auspices. No such major independent evaluation has been done since the prevailing premiums and reserve structures were established several decades ago. It would contribute to a better understanding of the product and more rational and consistent state rate regulation, and would draw more objectively upon the industry's loss experiences over the past 20 years.

ALTERNATIVES RELATED TO TITLE INSURANCE

The title assurance and conveyancy processes which we identified as contributing to or indicative of a lack of workable competition were:

- competition for sources of referrals rather than directly for consumers;
- widely varying prices for essentially the same services;
- inconsistent product characteristics; and
- inconsistent state regulation of rates.

Alternatives which we analyzed to address the problem of unreasonable or widely varying prices were:

Alternative 1: Establish Open Competition or Deregulation of Rates

Deregulation of title insurance rates by the individual states would mean that the industry was no longer protected from antitrust actions under the McCarran-Ferguson Act. Whether title insurance was specifically exempted from the act or not, price collusion would be illegal.

Our survey data indicate that competetive pressure within the title assurance "industry" was not sufficient to induce an immediate decline in prices in most areas. Other alternatives are preferrable. Consequently, we cannot support this approach in the absence of other steps.

Alternative 2: Initiate Federal Regulation of Title Assurance Charges

We believe the cost and dislocation resulting from a federal takeover of traditional state insurance commission functions would outweigh the probable savings to consumers in title assurance fees.

Alternative 4: Promote Uniformity of State Rate Regulation

We belive that state regulation of the price of a total package of title assurance and conveyancing services using consistent and well thought out definitions of industry costs and profits could lower charges in many areas. Past state regulation has focused principally on industry-defined needs and not upon total charges paid by the consumer.

The vehicle that has been proposed to achieve more effective and consistent state regulation could be a Uniform Title Insurance Regulatory Act. This proposal as drafted would cover both premiums, reserves, and charges for title assurance related services. It could also regulate other aspects of the provisions of title assurance, such as those noted below. We recommend that the development of a Uniform Act be strongly considered. Sponsorship of this initiative would probably best reside in HUD's congressional oversight committees with development assistance from PD&R, NAIC, and ALTA.

Interlocking relationships resulting from and, perhaps, contributing to high charges in the title assurance industry have been attacked often. Referral fees and kickbacks were prohibited by RESPA. Legal referral relationships among brokers, attorneys, and title insurance companies continue. Alternatives which have been proposed for dealing with reverse competition include the following:

Alternative 5: Prohibit Controlled Business or Ownership of Title Companies or Agencies by Referrers Such as Lenders, Real Estate Brokers, and Attorneys

The ownership of underwritten title companies by referrers appears to have expanded in the last few years. These companies provide the search and evaluation function, but the actual risk is covered by title insurance underwriters. These referrer-owned companies have an assured source of business and little or no marketing costs. The real estate broker-owned firm is becoming more widespread but companies owned by lending institutions are also classified by an interpretive HUD ruling as controlled business since the owners are sources of referrals.

The effect of controlled business on prices remains unclear, since prices are already high under most types of reverse competition irrespective of the particular provider in one linkage. Such a prohibition would not preclude commissions being paid to attorneys, nor payment of other implicit referral fees.

We believe that such a prohibition would be a band aid solution and would not necessarily result in lower title assurance charges. In addition, it is inconsistent with congressional interest vis-a-vis the operation of service corporations.

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Alternative 6: Require Multi-Provider Referrals by Lenders and Real Estate Brokers

Lists of three to five acceptable attorneys on title insurance firms along with prices charged would be given to customers rather than recommending one provider. We believe that this method of increasing consumer awareness and shopping has merit and should be adopted. Such a list should include the lenders' associated service corporate where applicable, along with disclosure of the business relationship.

Inefficiencies in the product of title assurance also exist. There are two alternatives which we believe could be easily adopted to make the product easier to understand and which would result in lower charges. The following alternatives could be implemented by the title insurance industry through its trade association with proper oversight of the Justice Department to avoid antitrust violations.

Alternative 9-1: A Single Policy

There does not appear to be any reason for separate lender's and owner's policies. One policy covering both the mortgage and equity amounts with the same restrictions and exclusions for each policyholder appears to us to be preferable. Consolidation into a single policy would have no effect on the marketability of mortgage portfolios or on the secondary mortgage market.

Alternative 9-2: Discount for Subdivisions and Condominiums

Where one title insurance policy for a property has been issued and the property is then divided, the final consumer should receive a substantial discount over the regular price of title assurance. This is a current practice in Wyoming.

One further proposed alternative regarding product provision that we analyzed was:

Alternative 10: Require the Seller to Pay Title Assurance Costs

Sellers already pay for title assurance services in many states. Such an approach might lower the buyer's costs but does not necessarily reduce total settlement charges. Consequently, we are neutral on this approach.

ALTERNATIVES RELATED TO BROKERAGE SERVICES

Our analysis of the market of brokerage services indicates substantial price uniformity and lack of active price competition in most localities, although strong competition exists for listings and other factors. The alternatives proposed seek to promote more active price competition and provide better representation for the buyer in the real estate transaction.

Alternative 1: Encourage Publicizing the Non-Fixed Price Nature of Commission Rates

For various reasons, many sellers are not aware that the commission rate is negotiable. This alternative seeks to increase consumer awareness that terms of the listing agreement are negotiable. This would be done through press and public relation activities of federal, state, and local officials and also through revision of the SIB, which would be distributed by brokers. We urge that this alternative be implemented by the industry and believe it will contribute significantly to increased price competition.

Alternative 2: Ensure that the Multiple Listing Service (MLS) Does Not Operate to Restrict Price Competition

The MLS could serve to restrict deviation from prevailing commission rates by:

- denying membership to discount brokers;
- requiring that the commission rate be the prevailing one in the area; or
- explicitly listing the commission rate and rate split.

The first two practices are illegal. Listing commission rate splits can facilitate brokers using boycotts or other measures to discourage price cutting.

This alternative is intended to (1) monitor MLS activities and to effectively enforce federal and state antitrust laws as they apply to activities of brokers and MLSs; and (2) prohibit the listing of commission rate and rate splits by the MLS. We believe that the first part of this alternative has merit but the second does not.

OVERVIEW OF ALTERNATIVES

The alternatives evaluated tend to fall into four broad categories:

- approaches which seek to improve competitiveness and performance of individual settlement provider markets;
- approaches which seek to lower charges through direct regulation of settlement prices and practices;
- approaches which seek to reduce regulatory involvement in settlement markets; and
- approaches which seek to package settlement services at the most competitive point with the settlement process (lender-pay).

No one of these categories has exclusive merit in our framework of evaluation. However, we favor alternatives that reduce regulatory invlovement and instead promote competitiveness within markets through consumer information and increased consumer shopping. A more detailed evaluation of each alternative summarized here is presented in the body of Volume III of our report.

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